LOS ANGELES BAR BULLETIN

In This Issue

Vol. 34 DECEMBER 1958 No. 2

"Someone should tell him about Title Insurance and Trust Company"

Once is enough to pay estate taxes! Multiple taxation of your client's estate can be avoided if the right steps are taken at the right time. The Accounting Section of our Estate Planning Department is available to help you attain that happy result and other tax savings — without cost.

Our trust services also afford you and your client experienced help in handling probate, testamentary trust, living trust, and other fiduciary matters. For probate and all other legal services, we retain the attorney who drafted the instrument. Call our Estate Planning Department, MAdison 6-2411.

Southern California's TI *Oldest Trust Company*

Title Insurance and Trust Company

433 SOUTH SPRING STREET, LOS ANGELES 54

Los Angeles
BAR BULLETIN

Official Monthly Publication of The Los Angeles Bar Association, 241 East Fourth Street, Los Angeles 13, California. Entered as second class matter October 15, 1943, at the Postoffice at Los Angeles, California, under Act of March 3, 1879. Subscription Price $2.40 a Year; 20c a Copy.

VOL. 34 DECEMBER, 1958 No. 2

President's Page

IMPOSITION OF CHANGES IN THE ADMINISTRATION OF JUSTICE BY LEGISLATION

By E. AVERY CRARY
President, Los Angeles Bar Association

E. Avery Crary

A subject of grave importance to the public and members of the Bar in particular is the ways and means of expediting court procedure, which has been under study and discussion for several years. In my opinion, the time is rapidly approaching when drastic measures will be urged with force which could well result in serious and injurious effect on the best interests of the public.

All of the members of our profession will agree that in order that there be a just determination of litigated matters there must be maintained the opportunity for a person to present his case through counsel to a court of law in accordance with the rules of evidence as established by the statutes and as interpreted by the courts. The disposition of tort litigation by production line procedures would work a great injustice to all who become parties to litigated disputes, as well as to the public at large.

The tremendous population growth in California results in ever present need to increase the number of courts. As Chief Justice Warren said in his address at the dedication of the new Los Angeles Courthouse last month, 250 Superior Courts will be needed in the

county before the turn of the century. This estimate is probably on the conservative side. I conclude from attendance at some of the hearings of the Legislature's Joint Judiciary Committee that it is the consensus of the Legislature that more must be done to shorten the interval between the institution of action and its final disposition by trial, and that there must be changes in the procedure presently followed to accomplish the desired result in addition to increasing the number of judges.

Science has achieved wonders in "shortening" distances, in minimizing the time interval for communication and in simplifying the maintaining of records. Court procedures are, of course, not susceptible of disposition by mechanical devices, but there are means for their expedition. It is the duty of the legal profession to foster such means in order to avoid the imposition of robot procedures.

Those who heard Senator Regan, Chairman of the California Legislative Joint Judiciary Committee on the Administration of Justice, at the last meeting of our Association are well aware of

Issue Editors — Marshall Ross and Theodore J. Elias

the studies being made by the Legislature preliminary to the introduction of legislation aimed at improving court procedures.

It is easy and not unnatural for use who are used to the existing procedures to say any change would not be in the interest of justice. But we, as lawyers, have no vested interest in the processes by which law suits are determined. With good reason the Legislature has determined that present procedures result in undue delay in litigation and changes by appropriate legislation are necessary.

Some of the important points considered by the hearings of the Joint Judiciary Committee are:

1. Questioning of the jury on Voir Dire by the court with the right of counsel to submit questions to the court in writing;
2. Reduction of the number of jurors to 8 and proportionate reduction in peremptory challenges;
3. Determination of liability before damages;
4. Consolidation of Superior and Municipal Courts;
5. Additional judges;
6. Discretion in the Superior Court pre-trial judge to transfer personal injury cases to Municipal Court if thought to be within the jurisdictional limits of that court (New Jersey Plan);
7. Increasing the jurisdictional limit of the Municipal Court;
8. Proposal for use of court-appointed medical experts as outlined by Senator Regan in his recent talk before the Association.
9. Sanctions in the form of mandatory assessment of costs or attorneys' fees or both where judgment in Superior Court not in excess of the jurisdictional amount of the Municipal Court.

Space does not permit a discussion of the merits or demerits of changes being considered. Suffice it to say, by way of example, that the fact that we have for these many years been privileged to try tort cases before a jury of 12 persons, if demanded, does not make it unreasonable to believe a jury of 8 could determine the facts without violating any of the interests of justice or interests of the parties involved. I am advised that Florida statutes provide for trial of civil cases by *six* jurors with satisfactory results.

Our courts are exhausting every available means to keep the trial

calendar from lagging. Should not we, as lawyers, be out in front with suggestions for changes in procedures which will lend "a big assist" in solution of the problem without substantial violation of the rights of litigants to fair and just trials of their cases?

The Legislature will start formulating legislation to effect appropriate changes in January, 1959. Right now your Board of Trustees is considering many of the items which are being studied by the Joint Judiciary Committee and will submit recommendations thereon to the Legislative Committee within a short time. Your views on the points involved are solicited.

Selling a Business Interest—

TAXING THE SELLER ON A CONTINGENCY RESERVE SET ASIDE TO PROTECT THE BUYER

By JAMES H. KNECHT, JR.*
Third Place Winner
1958 Junior Barristers Essay Contest

It is common practice in the purchase of a business, whether the subject of the purchase is stock of a corporation, partnership interests or business assets, for the buyer to require part of the purchase price to be held in escrow or trust as a contingency reserve for the performance of the seller's warranties. This is particularly true where the buyer will not be paying installments over a protracted period of time which would provide setoffs against breaches of warranty made by the seller. The seller, however will not want to pay a capital gain tax in the taxable year of the sale based upon receipt of the entire amount of the purchase price.

One reason for the seller's desire to defer gain on the reserve is that he may be in an appreciably lower tax bracket in a later year and pay a smaller net tax than if all of the gain were taxed in the year of sale.[1] Also, the net sale price may ultimately be reduced if breaches of the seller's warranties diminish the amount of the reserve he finally receives. This would put the seller to the task of filing a claim for refund due to overpayment of the capital gain tax in the year of the sale and could raise vexing problems respecting the seller's overall tax liability.[2]

---

*Associated with Forster & Gemmill, Los Angeles.

[1]Section 453(b) of the 1954 Internal Revenue Code also permits the deferment of recognized gain on a sale of realty, or a casual sale of personalty, if payments received by the seller do not exceed 30% in any taxable year. The ratable amount of gain included in each installment is taxed in the year of receipt, which may also result in much less than the maximum tax of 25% on capital gains. However, in taxing a sale or exchange in which a contingency reserve is involved, assuming Section 453 does not apply, the entire adjusted basis of the asset is applied against the purchase price received in the year of sale to determine capital gain or loss. When the contingency reserve is ultimately received, the entire amount will be treated as capital gain and be subject to offset by the normal capital loss carry-forward rules if reporting by this method produced capital loss in the year of the sale. *Cf.* Goetze Gasket and Packing Company, Inc., 24 T.C. 249 (1955).

[2]Where income, reported in a previous year because the taxpayer had an "unrestricted right" to it, is "restored" by the taxpayer in a subsequent year, Section 1341 permits a tax adjustment in the year of "restoration" which obviates the filing of a claim for refund. Query, however, whether Section 1341 would apply where the seller obviously does not have an "unrestricted right" to the reserve in the year of the sale, and where he never "restores" anything to the buyer. The Commissioner's regulations do not seem to contemplate this problem. Reg. Sec. 1.1341-1. Therefore, if the seller is deemed to

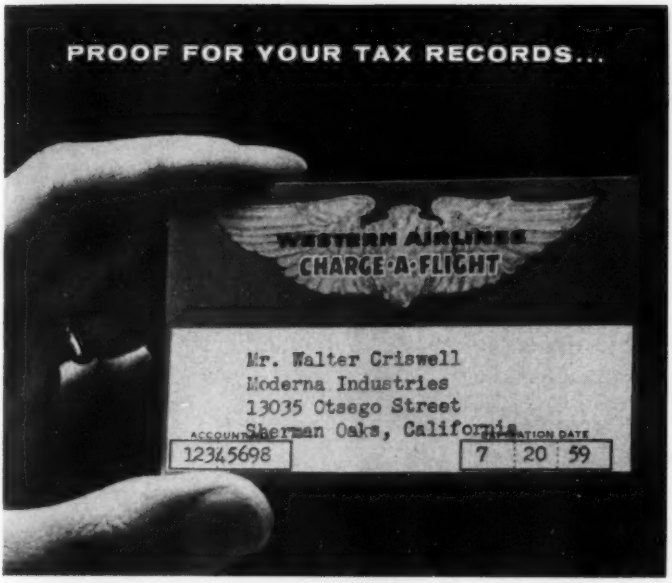
The principal reason most taxpayers would rather defer payment of the tax on the amount of the contingency reserve is that they have an aversion to parting with tax money before their tax liability is definitely fixed. The seller would be especially concerned if he has received consideration other than cash or would for other reasons be hard-pressed to pay tax on the entire sale price. Generally, it may be concluded from the cases that the transaction can be arranged both for the protection of the buyer and to accommodate the tax objectives of the seller.

Analysis of the cases must begin with an examination of Section 1001 of the 1954 Internal Revenue Code which provides that the "amount realized" upon the sale or exchange of a capital asset is the sum of the money "received" and the fair market value of property other than money "received" in the transaction. Where a contingency reserve is held beyond the seller's reach in escrow or in trust for a lengthy period and the ultimate amount which he will receive is uncertain, the seller will argue that he has not received either the fund or a fixed right to the fund in the year of the sale. On the other hand, the Commissioner may take the position that the contingencies are imaginary, or feel that the seller's right to receive income on the fund or right to manage and control the fund result in his constructive receipt of the reserve in its entirety at the time of the sale. It is assumed that the buyer may be justly concerned with the state of title to property, the payment of accounts receivable, the existence of various creditors' claims, or any of the contingencies as to which the buyer may have bargained for the seller's warranty. If the buyer's apprehension about the contingency is genuine, the Commissioner's argument must hinge on the legal conclusion that the reserve itself, or an absolute right to receive the reserve, was obtained by the seller in the year of the sale.

If the purchaser places the full price in escrow and there is no provision respecting a refund upon the breach of a warranty by the seller, the seller will clearly be taxed on the full price in the year the transaction occurs and cannot alter the tax consequences

(Continued on page 53)

receive the entire purchase price in the year of the sale and is taxed accordingly, it could be argued that he has no recourse to a refund if the amount he finally receives is less than the original price and the period for filing a refund claim has expired. However, on the strength of Arrowsmith v. Commissioner, 344 U.S. 6 (1952), it seems that the seller would have a capital loss deduction in the year the reserve is received to the extent that a loss has been realized in such year due to a breach of warranty. Even after applying the *Arrowsmith* principle, the taxpayer may be the loser if he has insufficient capital gains against which to offset the capital loss.



Now's the time to get this NO DEPOSIT air travel credit card

Itemized monthly statements are often necessary to establish income tax deductions for business travel. That fact makes a Western Airlines Charge-a-Flight card *invaluable*. It's good everywhere on Western's 9,000-mile system in the 13 Western states, Canada, and Mexico. And you can get one with *no deposit!*

WESTERN AIRLINES

Escrow Agreements—How Enforceable Are They?

By ARTHUR G. BOWMAN*

Arthur G. Bowman

Various matters of special concern to purchasers of real property, to be considered with particularity when going into an escrow transaction, were discussed in a previous issue of the BAR BULLETIN in an article entitled "Representing the Buyer in Escrow." (December, 1957.) A problem which appears to arise frequently, and which is involved in several recent decisions, relates to conditions imposed in the escrow instructions by a buyer which qualify his obligation to perform.

A buyer may wish to reserve the right of approval of any one of numerous items of concern to him before he can be compelled to perform, which require additional time to investigate and obtain necessary information regarding the suitability of the property for his purposes. These items may pertain to zoning, covenants, conditions and restrictions, easements, reservations, financing, leasing, etc.

By the inclusion of qualifying language in the escrow instructions for the protection of the buyer, a question arises as to whether or not the transaction has all of the necessary elements of an enforceable contract. Can the buyer obtain specific performance of the escrow instructions if the seller refuses to perform? The recent case of Prather v. Vasquez, 162 A.C.A. 195 is illustrative of this problem, and discloses material loss to a buyer resulting from the inclusion in the escrow instructions of provisions designed to "protect the buyer."

In that case, the purchaser brought an action for damages for failure to convey approximately 58 acres of agricultural land in La Puente; also, the real estate broker sued for a commission in the sum of $12,000. Escrow instructions were executed on July 15, 1954, between the seller and the purchaser, which contemplated a

*Mr. Bowman is a member of the State Bar of California, Los Angeles County Bar Association, and the Bar Association of the Territory of Hawaii. He is Associate Counsel for Title Insurance and Trust Company and the author of the recently published "REAL ESTATE LAW IN CALIFORNIA" (Prentice-Hall, 1958).

sale of the property for $232,000 on the basis of $4,000 an acre. The escrow was to close on December 1, 1954, with the purchaser to deposit $67,280 and a trust deed securing a note for $164,720, payable January 5, 1955. The broker was to receive a $12,000 commission payable from the funds accruing to the seller at the close of escrow.

The escrow instructions contained the following special provisions, prepared by the escrow officer at the purchaser's request: "Subject only to . . . covenants, conditions, restrictions and public utility easements of record . . . *subject to my approval.*" "It is understood and agreed that: . . . (3) In the event of cancellation the buyer is to pay all charges." "This escrow may be terminated by the seller at any time after 139 days from the date hereof, provided, the buyer does not deposit the funds agreed upon in this escrow, or the date of such deposit may be extended by the seller from time to time. *Termination of the escrow by the seller as herein provided shall be the seller's only remedy for buyer's failure to carry out the terms and conditions hereof and seller shall not be entitled to damages or specific performance as against the buyer, anythings (sic) in these instructions contained to the contrary notwithstanding.*"

On September 18, 1954, the sellers gave written notice of cancellation of the escrow instructions. The purchaser refused to agree to a cancellation, and rejected a subsequent offer by the seller to sell the property for $4,200 an acre. In October, 1954, the seller brought an action for declaratory relief; this action was dismissed sometime after December 1, 1954. The purchaser did not deposit the $67,280 or the trust deed in escrow, and the acreage was later sold to a third party for $4,800 an acre, representing an increase in the value of the property totalling $46,400.

Action for damages by the buyer and the broker resulted. The first cause of action alleged that the escrow instructions created a binding contract for the purchase and sale of the acreage. A general demurrer to this cause of action was sustained by the court without leave to amend, upon the ground that the escrow instructions did not constitute an enforceable contract of sale. Judgments of nonsuit were subsequently entered and affirmed on appeal.

Testimony at the trial disclosed that the buyer caused the special provisions to be included in the escrow instructions in order to protect him in the event the acreage was not suitable for subdivision

purposes. As a result of the special provisions, compliance with the terms of the escrow was left wholly to the purchaser's discretion. Since the agreement was not binding on the purchaser, the court concluded that it was not binding on the seller, and the seller's cancellation of the escrow therefore did not constitute a breach of an enforceable agreement to convey the property to the purchaser. The court stated at page 200 as follows:

> "It is settled that a contract for the purchase and sale of real property is not binding on either party unless its obligations are mutual and reciprocal; where, under the terms of an agreement, performance is optional with one of the parties and the option is not exercised, the agreement lacks mutuality of obligation and it cannot be enforced against the other."

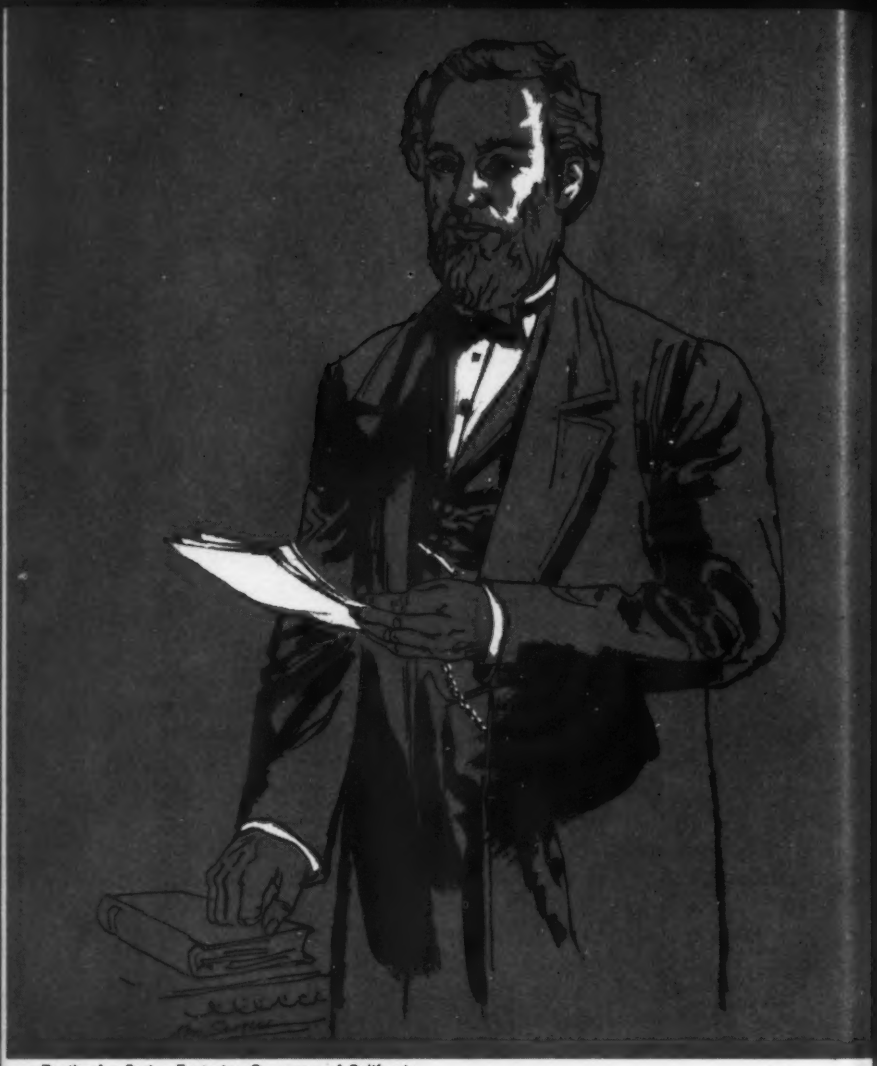
A recent decision of the California Supreme Court which appears distinguishable from the above case involved the enforceability of a deposit receipt containing a provision which made the purchaser's performance dependent upon his obtaining satisfactory leases. It was held that the inclusion of such a provision did not render the contract illusory or lacking in mutuality, and the contract was enforceable by the buyer. Mattei v. Hopper, 51 A.C. 117.

In that case, the plaintiff, a real estate developer, was planning to construct a shopping center on a tract adjacent to the defendant's land. Plaintiff accepted the offer of defendant to sell her property for $57,500 and executed a deposit receipt under which he was required to and did deposit $1,000. Plaintiff was given 120 days to examine the title, and the balance of the purchase price was due upon tender of a sufficient deed. The concluding paragraph of the deposit receipt provided as follows: "Subject to Coldwell Banker & Company obtaining leases satisfactory to the purchaser." This provision was desired as a means for arranging satisfactory leases of the shopping center buildings prior to the time the purchaser was committed to pay the balance of the purchase price.

Before the elapse of the 120 days, the seller notified the buyer that she would not sell the land under the terms contained in the deposit receipt. Thereafter, the seller was informed that satisfactory leases had been obtained, and the buyer offered to pay the balance of the purchase price. Seller refused to consummate the deal, and this action for damages resulted.

The trial court held for the defendant seller on the theory that the agreement lacked mutuality. The Supreme Court reversed the

(Continued on page 59)



Tenth of a Series Featuring Governors of California

Henry H. Haight

Lawyer, educator . . . CALIFORNIA'S TENTH GOVERNOR, 1867-1871

He gave up a flourishing law practice to serve his state. In 1869, he saw the last golden spike driven home in America's new transcontinental railroad. "It links together in iron bonds the two great oceans of the world," he said, "and carries California . . . into the center of the great family of nations." He served on the University of California's Board of Regents prior to his death in 1878 —just twenty-eight years before Security-First set up its Trust Department. Since then, our services have benefited three generations of Southern Californians.

TRUST DEPARTMENT

SECURITY-FIRST NATIONAL BANK

Southern California

Opinion of Committee on Legal Ethics Los Angeles Bar Association

Opinion No. 246

(October 28, 1957)

CONFLICTING INTERESTS—DISCLOSURE—PRESERVATION OF CONFIDENCES. An attorney may be employed by a private law firm after severing his relationship with a governmental legal body which is involved in litigation with the private firm if consent, express or tacit, has been given by all parties concerned. However, it is improper, upon the request of the governmental legal body for assistance from its said former attorneys in connection with previously commenced litigation against the client of the private law firm, for the private law firm to ask the client's consent with respect thereto.

A firm of attorneys has submitted the following factual situation and has requested an answer to the two questions thereafter propounded.

STATEMENT OF FACTS

Attorneys A and B were employed by a public body, serving in the legal department which handled condemnation matters. In 1955 Attorney A determined to leave the employ of the condemnor and to enter private practice, specializing in eminent domain matters. He sought employment with XYZ law firm, a Los Angeles firm in general practice, with a condemnation department. He was employed by the XYZ law firm in October, 1955.

In late 1956 Attorney B likewise made the same decision to enter private practice. He, also, was employed by the XYZ law firm in January, 1957.

At the time each attorney left the public body and became associated with the XYZ firm, there were pending various condemnation cases in which the XYZ firm represented the landowners against the condemning body. It was understood that attorneys A and B would have no part in any litigation against the condemning body about which they had acquired special knowledge during their employment, or any litigation on file at the time of their respective departures, even though they may not have had special knowledge concerning it, without the consent of the condemning body. The condemning body made no objection to the employment of attorneys A and B by the XYZ firm.

One such pending condemnation action had been filed in December, 1952, to acquire property of the Alpha Company. On or

about June 10, 1953, the XYZ firm had been associated with the regular, counsel of the Alpha Company for the purpose of representing the company in the eminent domain proceeding.

In July, 1953, the condemning body revised its construction plans and changed the description of the property sought to be condemned. The Alpha Company by answer in the condemnation action sought to recover damages alleged to have been sustained as a result of the change in plans.

The condemning body successfully demurred and moved to strike the cause of action for such damages from the condemnation action. Attorneys A and B participated in the preparation of the motion to strike and the demurrer on behalf of the condemnor.

The claim for damages subsequently was then made the subject matter of an independent action brought by the company against the condemnor in mid-1955. Attorneys A and B participated in pleading phases of this case for the condemnor. This action is now at issue and is awaiting trial.

The condemnation phases of the litigation were subsequently tried and fully concluded by the end of 1956. Attorney B participated actively in the trial of the condemnation litigation along with others on behalf of the condemning body.

There remains pending for trial the above-mentioned suit for damages brought by the Alpha Company against the condemning body. XYZ firm are the sole attorneys of record for the company, the counsel formerly associated being no longer in the case. Neither Attorney A nor Attorney B has participated in the condemnation or damage litigation in any way for the XYZ firm, nor will they do so.

The Alpha Company was fully informed, prior to the employment of Attorneys A and B by the XYZ firm, of the firm's wish to employ the attorneys. It had no objection, and it still desires the XYZ firm to continue to represent it.

The condemning body (the present defendant) has now requested the XYZ firm to permit attorneys A and B to assist the condemning body in the preparation of its defense of the pending litigation. The request is made upon the basis that these attorneys, and especially Attorney B, have considerable knowledge of the background of the litigation and the facts of the case and that their assistance is essential to the adequate preparation of the condemnor's defense. It is understood that the assistance desired is not limited merely to a discussion of facts such as might be adduced upon a subpoena, but would include a discussion of legal principles.

The XYZ firm does not desire to be in the intolerable position where its attorneys are assisting the opposition against one of its

clients, nor does it wish to lay its clients or itself open to the charge that it is endeavoring to cripple the condemnor's case by refusing their assistance. The advice of the Committee is therefore respectfully requested on the following matters.

QUESTIONS PRESENTED

1. Should the XYZ law firm continue its representation of the Alpha Company in the pending litigation, or should it seek the client's permision to withdraw?
2. Whether the firm continues or withdraws, should the request of the condemning body for the assistance of Attorneys A and B be granted or denied?

The Committee observes that the condemning body and the Alpha Company have been fully advised of the associations of A and B with the XYZ firm and that A and B and the XYZ firm have faithfully complied with all of the requirements for ethical conduct including those set forth in the Canons and Rules of Ethics and Professional Conduct, respectively, quoted hereinafter in connection with the discussion of the second question.

It is the opinion of the Committee, therefore, that the XYZ law firm should continue its representation of the Alpha Company in the pending litigation. This opinion is based on the assumption that XYZ will follow the suggestions made in the advisory opinion as to the second question.

Before answering the second question, it might be well to quote from the following Canons of Professional Ethics and Rules of Professional Conduct.

Canon 6 of the Canons of Professional Ethics of the American Bar Association:

"It is the duty of a lawyer at the time of retainer to disclose to the client all of the circumstances of his relations to the parties, and any interest in or in connection with the controversy, which might influence the client in the selection of counsel.

"It is unprofessional to represent conflicting interests, except by express consent of all concerned given after a full disclosure of the facts. Within the meaning of this Canon, a lawyer represents conflicting interests when, in behalf of one client, it is his duty to contend for that which duty to another client requires him to oppose.

"The obligation to represent the client with undivided fidelity and not to divulge his secrets or confidences forbids also the subsequent acceptance of retainers or employment from others in

EXPERIENCED MANAGEMENT FOR YOUR CLIENTS' INVESTMENTS

Managing investments requires experience, specialized skill and a broad, up-to-date knowledge of business and economic conditions. Few investors have such qualifications.

That's why Bank of America can be of valuable service to your clients if they own securities. They have their choice of full management or limited advisory service.

Either way the bank provides custody of their securities, handling such things as stock rights, call dates, collection of bond coupons and dividends on stocks. The bank also gives periodic accountings to help with tax returns.

This Investment Management service is inexpensive. It costs nothing to open or close an account — all your clients pay is a small annual fee, which is tax deductible.

For the service that suits your clients best, ask at your nearest branch.

Our booklet EXPERIENCED MANAGEMENT FOR YOUR INVESTMENTS will show how your clients can profit by this Bank of America service.

Write or call for your copy today!

Bank of America
NATIONAL TRUST AND SAVINGS ASSOCIATION

MEMBER FEDERAL DEPOSIT INSURANCE CORPORATION

matters adversely affecting any interest of the client with respect to which confidence has been reposed."

The provisions of Canon 37 of the Canons of Professional Ethics of the American Bar Association which are pertinent to this question:

"It is the duty of a lawyer to preserve his client's confidences. This duty outlasts the lawyer's employment . . . and the lawyer should not . . . accept employment which involves or may involve the disclosure or use of these confidences, either for the private advantage of the lawyer . . . or to the disadvantage of the client, without his knowledge and consent, and even though there are other available sources of such information. A lawyer should not continue employment when he discovers that this obligation prevents the performance of his full duty to his former or to his new client."

Canon 29 of the Canons of Professional Ethics of the American Bar Association:

"An attorney . . . should strive at all times to uphold the honor and to maintain the dignity of the profession . . . "

Rule 5 of the Rules of Professional Conduct of the State Bar of California:

"A member of the State Bar shall not accept employment adverse to a client or former client, without the consent of the client or former client, relating to a matter in reference to which he has obtained confidential information by reason of or in the course of his employment by such client or former client."

Rule 6 of the Rules of Professional Conduct of the State Bar of California:

"A member of the State Bar shall not accept professional employment without first disclosing his relation, if any, with the adverse party, and his interest, if any, in the subject matter of the employment."

Rule 7 of the Rules of Professional Conduct of the State Bar of California:

"A member of the State Bar shall not represent conflicting interests, except with the consent of all parties concerned."

The Statement of Facts does not reveal that Alpha Company has been informed of the request of the condemning body that the assistance of A and B be given to the condemning body for the purposes mentioned. Alpha Company, the client of the XYZ firm, is, of course, entitled to a full disclosure of the facts and it would be necessary for it to consent to the employment of A and B by the con-

demning body for the purposes stated. This is true even though A and B may be employees of XYZ and not partners.

The question then arises as to the propriety of XYZ requesting the consent of the Alpha Company and as to this the Committee believes that it would not be fair to the Alpha Company to request, or even to accept, the consent of the Alpha Company if it were voluntarily offered. It must be assumed that the Alpha Company might ultimately lose the pending litigation and suspicions might then arise from the fact that lawyers in the same firm had appeared on both sides of the controversy. This possibility should be avoided. It can even be said that the public might get the impression that all was not well or above suspicion and in either event the reputation of the Bar would suffer.

According to Henry S. Drinker's "Legal Ethics," at page 103, "The injunction against being on both sides of a case goes back to earliest times, being contained in the London Ordinance of 1280."

The XYZ firm must be considered to be one entity and the fact that its employees A and B have not participated on its behalf or that of the Alpha Company in the condemnation matters between the condemning body and the Alpha Company does not alter its position.

The obligation of attorneys to represent the client with undivided fidelity has been applied to law partners representing different clients who have interests conflicting with one another, to lawyers not partners, having offices together, and even to a lawyer who had had an informal discussion with a lawyer for the other side during a trial when asked to take part in an appeal. (See notes 36, 37 and 39 on page 106 of the above mentioned "Legal Ethics.")

In this situation under the Canons and Rules cited above, the XYZ firm should inform the condemning body that it is anxious to avoid the appearance of impropriety which would exist if its employees consulted with and advised the condemning body on a matter for which XYZ were the attorneys of record for the opposing party, and that in any event the XYZ firm would not impose upon its client, the Alpha Company, to the extent of requesting it to give its consent to such an arrangement.

This opinion, like all opinions of this Committee, is advisory only. (By-Laws, Article X, Section 3)

Brothers-In-Law

By George Harnagel, Jr.

George Harnagel, Jr.

"Regardless of religious faith, we can all agree that in a manger in Bethlehem . . . there was born one whose teachings have more profoundly influenced civilization than those of any other being on earth.

"His teachings tempered the Mosaic law with forgiveness, the Roman law with mercy, the English law with freedom for the individual, and inspired our forefathers to dedicate a government to the rights of 'life, liberty and the pursuit of happiness' for all, as equals under the law. . . .

"To our profession is given the duty of upholding those principles. Being in large measure the law givers, the law interpreters and the law enforcers, ours is the obligation to see that laws be just, trials fair and punishment merciful.

"The Christian way of life is essentially the Golden Rule applied to our daily dealings with each other. It is a rule for Monday as well as Sunday, and all the days of the week. It should be applicable in our offices and court rooms, equally as in the pastor's study. As we deviate, to the same extent we undermine our society. . . ."—Christmas letter of Clarence Kolwyck, Chattanooga, Tenn., 1956 president of the Tennessee Bar Association, to the lawyers of Tennessee.

* * *

"Anatomy of a Murder" is the only best seller we can recall offhand as having been written by a State Supreme Court Justice. If you liked its pungent prose, you may also enjoy the majority opinion in *People v. Hildabridle,* 92 N.W.2d 6 (Mich., 1958) from the pen of the same author. In this case, by a divided court, a raid on a secluded nudist camp was held to constitute an illegal search and seizure. Justice Voelker, with two other justices concurring, went on to hold that the occupants of the camp did not violate the indecent exposure statute.

Two samples are submitted below, the first on the search and seizure, the second from the prelude to the discussion of violation:

". . . [T]o say that the search and arrests here were illegal is an understatement. It was indecent—indeed the one big indecency we find in this whole case: descending upon these unsuspecting souls like storm troopers; herding them before clicking cameras like plucked chickens; hauling them away in police cars and questioning them for upwards of 5½ hours and taking still more pictures; and then, final irony, swearing out warrants that *one of their own number* was the aggrieved victim of an indecent exposure. . . ."

"Lest I henceforth be heralded as the patron saint of nudism (which I probably will be anyway), I hasten to preface what follows by stating that I am not a disciple of the cult of nudism. Its presumed enchantments totally elude me. The prospect of displaying my unveiled person before others, or beholding others thus displayed, revolts and horrifies me. I think these people have carried an arguably valid basic idea (the deliberate de-emphasis of the prevailing Western body taboo, with the anticipated lessening and ultimate disappearance of the undoubted eroticism frequently attendant upon such taboo—that is, the very opposite of indecency) to excessive lengths."

* * *

The November-December, 1958, number of *Case and Comment* reprinted the article on "What Makes a Lawyer Tick?" by E. Avery Crary, president of the Los Angeles Bar Association, which constituted his "President's Page" in the May, 1958, number of *Los Angeles Bar Bulletin.*

SELLING A BUSINESS INTEREST

(Continued from page 38)

by voluntarily imposing a deferment in the receipt of the proceeds.[3] Under an earlier line of decisions, however, the Board of Tax Appeals held the gain fully taxable even where a bona fide contingency existed which deferred the seller's receipt of part of the proceeds and raised a substantial uncertainty as to the amount of his ultimate taxable gain. In *Federal Development Company*,[4] the seller of real property was required to warrant that certain agreements would be executed requiring lessees to vacate. A reserve of $50,000 was established to guarantee performance of the agreements and satisfy a liquidated damages provision for any holding-over period. The entire purchase price was received by the seller and the reserve amount was repaid to the buyer, the seller receiving interest on the fund during the period of the contingency. It was held that the seller was taxable on the entire amount in the year that title was transferred notwithstanding the uncertainty of the final taxable gain.

Similarly, in *Scott P. Myers*[5] there was a sale of corporate stock as to which the seller warranted that his minor daughters had no interest. A trust fund of $200,000 was established which was to be held until the daughters reached majority and their interest, if any, could be determined. In this case the seller directed the investment of the trust fund and received the income therefrom and, in reliance upon the *Federal Development* case, the court held that the seller was taxable in the year of the sale on the full $200,000 reserve.

Blaine L. Stoner[6] involved the sale of stock under an agreement whereby the seller placed $50,000 in a bank "indemnity account" which he managed in a fiduciary capacity for two years as protection against breach of warranties made by him in the course of the sale. In addition to managing the fund, the seller received interest on the deposited amount and again the Board of Tax Appeals, in reliance upon the *Federal Development* case, ruled that the seller

[3]Ottilie B. Kuehner, 20 T.C. 875 (1953), *aff'd*, 214 F.2d 437 (1st Cir. 1954).
[4]18 B.T.A. 971 (1930).
[5]30 B.T.A. 44 (1934).
[6]29 B.T.A. 953 (1934), *rev'd*, 79 F.2d 75 (3rd Cir. 1935), *cert. den.*, 296 U.S. 650 (1936).

realized taxable gain during the year of the sale regardless of the uncertainty surrounding the amount of the reserve and the time of its ultimate receipt. Notwithstanding the reversal of the *Stoner* case by the Third Circuit in 1935, the Eighth Circuit held in *Whitney Corp. v. Commissioner*[7] and *Bonham v. Commissioner*[8] that the taxpayers realized taxable gain on the reserve in the year of the sale.

Despite the foregoing line of precedents decided by the Board of Tax Appeals adversely to the taxpayer, later Tax Court decisions have gone uniformly against the Commissioner upon facts hardly distinguishable from the earlier cases. Although there have been no cases that expressly overrule the *Federal Development* case and succeeding decisions, such a reversal has, in fact, apparently taken place and the Commissioner in at least two instances has indicated his acknowledgment of this state of the law by issuing acquiescences.[9] *Preston R. Bassett*,[10] decided in the era of the *Federal Development* line of cases, concerned the sale of stock and the deposit in escrow of a $20,000 fund to indemnify the buyer against breaches of warranty. There was no evidence that the seller received interest on the fund and after nine months it was received by him in full. Partially in reliance upon the Third Circuit's reversal in the *Stoner* case, the Board of Tax Appeals stated, "What has generally been made decisive of the receipt of income by the taxpayer is whether he may exercise an unlimited command over it, and this holds true although for contractual or other reasons he may eventually have to part with some or all of it later on."[11] Continuing with *Marion H. McArdle*[12] in 1952, there has been a consistent pattern to the cases in favor of the taxpayer.

---

[7]38 B.T.A. 224 (1938), *aff'd*, 105 F.2d 438 (8th Cir. 1939). Stock of the purchasing corporation was placed in escrow to guarantee future earnings of a newly organized corporation, one share of which was to be forfeited for each $90 of unrealized profits. It was stipulated that the stock had a fair market value of $80 per share at the time of the sale, and that therefore the value of the right to receive the withheld shares was ascertainable in the year of the sale. *Cf.* J. Darsie Lloyd, 33 B.T.A. 903 (1936).

[8]33 B.T.A. 1100 (1936), *aff'd*, 89 F.2d 725 (8th Cir. 1937). The buying corporation transferred its shares on its books to the seller, but retained some of the shares in pledge as a guarantee that the purchase bank assets had their represented value. The court recognized a valid contingency and added dictum to the effect that the desired tax treatment might have been achieved but for the transfer of title in the shares.

[9]Marion H. McArdle, 11 T.C. 961 (1948), *acq.*, 1949-1 C.B. 3; Goetze Gasket and Packing Company, Inc., 24 T.C. 249 (1955), *acq.*, 1956-1 C.B. 4. Also see Rev. Rul. 151, 1953-2 C.B. 222, citing the *McArdle* case for the broad principle that income is not received for tax purposes so long as it is subject to a substantial restriction.

[10]33 B.T.A. 182 (1935), *aff'd per curiam*, 90 F.2nd 1004 (2d Cir. 1937). The Board attributed some weight to the taxpayer's cash basis of accounting.

[11]*Id.* at 191. Also see Cleveland Trinadad Paving Co., 20 B.T.A. 772 (1930), *aff'd*, 62 F.2d 85 (6th Cir. 1932), concerning an accrual basis taxpayer.

[12]11 T.C. 961 (1948).

In *McArdle*, the transaction involved the sale of stock for which the seller received certified checks from the buyer and endorsed part of the consideration back to the buyer pending the removal of certain contingencies. The seller received no interest on the withheld fund during the contingency period and although the court cited the earlier *Federal Development* and *Stoner* cases, the decision in *Bassett* was adhered to and the taxpayer prevailed.[13] The trend of these decisions was further extended in favor of the taxpayer in *Goetze Casket and Packing Co., Inc.*[14] In this case the selling corporations transferred all of their assets to the buying corporation for stock of the buyer plus cash. The sale contract required 1,000 shares of the buyer's stock to be held in a depositary account for three years, the dividends of which were paid to the seller. It was held that the seller received neither the shares of stock in the year of the sale nor any ascertainable right to receive the shares.

> "The evidence as a whole preponderates in favor of the conclusion . . . that the right had no ascertainable fair market value at that time. The number of shares which would be received eventually was subject at that time to a substantial contingency so that neither seller was required to include any value of the right in the amount realized from the sale. . . . The fact that the equivalent of dividends was paid (to the seller) on the stock during the three-year interval is not controlling."[15]

The latest indication of the Tax Court's view is found in *International Trading Co.*,[16] where the escrowed reserve was invested under the terms of the contract in shares of the purchasing corporation and the seller received dividends on the investment pending clearance of Federal tax liability. In holding for the taxpayer the court stated,

> "Here the fund deposited in escrow was not in the possession or control of the parties during (the year of the sale) nor could they know in that year how much of it they eventually would receive. Their right to it was subject to a substantial contingency. The parties were not required to include any value of the right

---

[13]The court in the *McArdle* case, referring to *Bassett*, came closest to overruling the earlier decisions, stating, "The cases of Federal Development Company, 18 B.T.A. 971, and Blaine L. Stoner, 29 B.T.A. 953, relied on by the respondent in that case *(Bassett)*, were discussed but were not followed." 11 T.C. at 963. The court placed some emphasis on the taxpayer's cash basis of accounting.

[14]24 T.C. 249 (1955).

[15]*Id.* at 255.

[16]17 TCM 521 (1958).

to the fund in the amount realized as gain (in the year of the sale."[17]

From these relatively few decisions it may be fairly concluded that the insistence of the buyer on a contingency reserve will not work to the seller's detriment taxwise and that such an arrangement can be agreed upon without great uncertainty. It is clear from all of the cases that there must first exist a real and substantial contingency against which the buyer is entitled to be protected. In an arm's length transaction, such a situation frequently arises and can normally be justified without difficulty, particularly if the problem is well documented in the sale contract. From the *Goetze* and the *International Trading* cases, it is clear that the right to receive income on the fund during the contingency period will not cause adverse tax consequences.

Assuming that the fund is retained by the buyer or at least held under a depositary agreement by a third party who cannot release it until the contingency period passes, there should be no adverse tax consequences if the seller is given power to direct investment of the fund. The holding of such a power was a factor in defeating the seller's tax position in the earlier *Myers* and *Stoner* cases,[18]

[17] *Id.* at 529.

[18] In the *Stoner* case, the Third Circuit reversed the Board of Tax Appeals since the seller held the power to invest in a fiduciary capacity.

FEDERAL COURTS CRIMINAL INDIGENT DEFENSE PANEL

The Los Angeles Bar Association recognizes with thanks the following attorneys who served on the Federal Courts Criminal Indigent Defense panel during November, 1958:

George M. Bryant
Sam Bubrick
Leo A. Burgard
John Edward Caldwell
Edgar R. Carver, Jr.
Richard R. Cody
A. Thomas Grazer
Edward I. Gritz
John Hart
Donald C. Kemby
Donald C. Klinkhammer
Morris Lavine
Herman R. Minken
William L. Todd, Jr.
John S. Turnbull

Volunteers for this vital work are still needed. Please call the Office of the Association.

however the language of the Tax Court in *Goetze* and *International Trading* indicates that the uncertainty of receiving the reserve is the primary criterion in deciding tax liability. Since the seller has the clear right to receive income during the escrow period without adverse tax consequences, it does not logically follow that the power to direct investments should nullify the desired tax status.

It should be noted, however, that neither of the Commissioner's acquiescences[19] has been given in a case which permitted the seller to determine the investment of the fund. A cautious rule of practice in this area would be to place restrictions on the seller's power, e.g., to limit investments to securities which are approved for fiduciaries.

Finally, it may be concluded that the seller's basis of tax accounting is immaterial; although the cases frequently allude to the accounting system of the taxpayer, the later decisions, at least, do not seem dependent upon the use of either the cash or accrual method.

In the last analysis, the government is not likely to sacrifice any appreciable revenue when it permits a deferment of gain on the reserve, particularly if the amount involved is large enough to require a maximum capital gain tax. Nor should such a deferment interfere with the government's orderly collection processes. Although reconciliation of all of the cases in this area requires the customary amount of factual hair-splitting, the later decisions indicate about as clearly as the tax planner could wish that a bona fide reserve for contingencies will escape taxation to the seller in the year of the sale if the few suggested caveats are observed.

[19]See note 9 *supra*.

ESCROW AGREEMENTS

(Continued from page 43)

lower court, holding that the provision making the obligation to purchase subject to the buyer obtaining satisfactory leases did not rob the agreement of mutuality of obligation. The court pointed out that there are many cases upholding satisfaction clauses dependent upon the exercise of judgment, and in such cases the criterion becomes one of good faith. In the instant case the buyer was given the privilege to terminate the agreement in the event he did not obtain satisfactory leases, but this did not leave him free to withdraw at his own unrestricted pleasure. Where the question is one of judgment, the promisor's determination that he is not satisfied, *when made in good faith*, is a defense to an action on the contract, but not otherwise.

Just where the courts might draw the line in determining whether or not a particular clause renders a contract illusory is difficult to say. The rule is recognized in the above decision that if one of the promises leaves a party free to perform or to withdraw from the agreement at his own unrestricted pleasure, the promise is deemed illusory and it provides no consideration. In order to avoid any uncertainty in this regard, it is preferable that the agreement, whether evidenced by a deposit receipt or escrow instructions or otherwise, set up some standard for revaluating the basis of the buyer's subsequent action with respect to items not presently ascertainable. If it does, there is less likelihood that a serious question will arise as to enforceability.

A buyer usually will know the type of deed restrictions that are unobjectionable, or the zoning regulations which will be agreeable, and can so indicate in the escrow instructions. The use of a general qualification that covenants, conditions, restrictions, etc., are "subject to buyer's approval," or a provision to the effect that the buyer reserves the right to approve "all matters shown on the preliminary report of title" is not recommended, as it may render the agreement unenforceable. Whether or not a buyer is acting in good faith will be more readily ascertainable if the condition imposed discloses the specific items of concern to the buyer.

The case of Frye v. George Elkins Co., 162 A.C.A. 268, also involved the problem of good faith on the part of a buyer in attempt-

ing to comply with a condition imposed in a real estate contract. It was held in that case that where a real estate contract is entered into on the condition that the buyer obtain certain financing, the buyer must in good faith attempt to secure the loan. If the buyer fails to take reasonable steps to obtain the loan, he is liable for any damage to the seller by reason of the failure of the contract to be performed.

Where conditions are imposed in escrow instructions presumably for the benefit of the buyer, a question may arise as to whether or not the buyer alone may waive such provision and be entitled to specific performance. This question was involved in the case of Spangler v. Castello (1956) 147 C.A. 2d 49, 304 P. 2d 752. In that case the buyer brought an action for specific performance of an escrow agreement to sell certain acreage near Fresno for subdivision purposes.

The escrow agreement provided, among other things, that the "escrow is contingent upon F.H.A. and V.A. approval." A sum to be deposited by the buyer was not placed in the escrow and no F.H.A. or V.A. approval was obtained within the prescribed time, and the seller thereupon gave notice of cancellation. The buyer brought this action for specific performance and claimed that he had been doing considerable work in preparation for the subdivision; that the provision in the escrow agreement in reference to the F.H.A. and V.A. approval was placed in there at his request; that he had waived that provision, placed there solely for his benefit, and he was entitled to waive it; and, accordingly, was not in default in this respect.

The seller's evidence included the testimony of an expert real estate appraiser who testified that the approval of the F.H.A. and V.A. played an important part in fixing the value of subdivision property and particularly in financing it and, if not obtained, conventional financing is necessary and if that is not obtained, the subdivision project itself may prove to be a failure for many reasons.

The court held in favor of the defendant seller, and specifically found that the buyer did not obtain an F.H.A. or V.A. approval as required by the agreement; that this provision was not inserted in the escrow agreement solely at the request of and to protect the buyer's interest, but the seller also was concerned with its inclusion; that said provision was in fact a condition for the benefit of

both the seller and the buyer, and could not be waived by the buyer alone.

Other cases have raised additional problems relating to uncertainty or lack of mutuality. In the case of Domino v. Mobley (1956) 144 C.A. 2d 24, 300 P. 2d 324, the buyers brought an action for damages for breach of a contract of sale of realty. The contract was evidenced by escrow instructions which provided that the escrow holder was to use and deliver the money deposited by the buyers and the papers to be deposited "provided instruments have been filed for record entitling you to procure assurance of title in the form of a joint protection Policy of Title Insurance issued by Title Ins. & Trust Co., in its usual form, with a liability of $60,000.00." The sellers contended that this provision rendered the contract uncertain and therefore unenforceable. The court concluded, however, that this argument is wholly without substance, stating as follows: "This is the prevailing form of escrow instructions in common use. King v. Stanley, 32 Cal. 2d 584 (197 P. 2d 321), says (p. 589): 'In the absence of express conditions, custom determines incidental matters relating to the opening of an escrow, furnishing deeds, title insurance policies, prorating of taxes, and the like.'"

It should be noted that following the above decision the quoted provision of the escrow instructions as set forth above has generally been changed to provide that the event of closing is dependent upon compliance with the following condition: "When you hold instruments, duly executed, upon the recordation of which (if recordation thereof is necessary) you can obtain a standard coverage policy of title insurance." This change in the form of escrow instructions has been recommended to overcome the problem encountered in the case of Todd v. Vestermark (1956) 145 C.A. 2d 374, 302 P. 2d 347, relating to the passage of title.

Another problem which sometimes arises and which may render escrow instructions unenforceable relates to certainty and completeness of the contract. The rule that an agreement must set forth the terms and conditions of all the promises constituting the contract applies to escrow instructions the same as to any contract. The case of Ferrara v. Silver (1956) 138 C.A. 2d 616, 292 P. 2d 251 is illustrative of this rule.

In that case a question was raised as to whether or not a contract

for the exchange of real property was sufficiently definite to permit an action for specific performance or for damages. Nonsuit was granted both as to specific performance and as to damages because of "indefiniteness and lack of completeness in the contract," particularly the indefiniteness of a commitment by the plaintiffs to construct "a banquet room building on westerly portion of Geary Boulevard lot," which lot plaintiffs were to convey to the defendant as part of the exchange.

In discussing the meaning of the words "banquet room building" the court raised many questions, as follows: How many banquet rooms? How large was the building to be? How much of the lot was to be covered? How much was it to cost? Was it to be of concrete, brick or wood? How many stories? How finished inside and out? The court then stated: "Clearly, there was no meeting of the minds on any of these questions, no mutual understanding of the meaning of the expression 'banquet room building' as used in this agreement at the time of its signing and no subsequent memorandum subscribed by the parties supplying this lack."

Another case involving uncertainty in a contract, evidenced by escrow instructions, is that of Gould v. Callan (1954) 127 C.A. 2d 1, 273 P. 2d 93, wherein it was held that the contract was too uncertain and indefinite to be specifically enforced by the buyer. The contract contained a provision for subordination of a second trust deed to the lien of a trust deed to be executed in the event the buyer should decide to construct a building on the property, but such provision failed to state the amount of interest and the terms and conditions of payment of the obligation to be secured by the later trust deed. The court concluded as follows: "The provisions are material and essential to a contract providing for a deed of trust as security for an obligation, and their absence is fatal to the claim for specific performance. The indefiniteness, uncertainty, and absence of all of the indicated materials and substantial terms of the alleged contract justified the trial court in denying specific performance."

From the foregoing discussion the conclusion is inescapable that extreme care must be exercised in the preparation of escrow instructions that are subject to various contingencies in order to avoid any contention that the agreement is unenforceable because it is illusory, uncertain, incomplete, or lacking in mutuality.

CAROLINE BREDE
PRINCIPAL LIBRARIAN-LAW SCHOOL
UNIVERSITY OF MINNESOTA
MINNEAPOLIS 14, MINNESOTA

F.U.L.

RETURN POSTAGE GUARANTEED
241 E. 4th Street
Los Angeles 13, Calif.